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FINANCIAL MANAGEMENT

USDA Faces Major Financial Management Challenges

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss U. S. Department of Agriculture (USDA) financial management issues. As evidenced by the Inspector General’s sixth disclaimer of opinion in a row on USDA’s consolidated financial statements, the agency has serious accountability problems over the $118 billion in assets and $120 billion in budgetary resources provided for fiscal year 1999 to carry out its diverse missions. Before USDA can achieve financial accountability, it or its component agencies must address a number of issues that we or USDA’s Office of Inspector General (IG) have reported as serious problems. My statement will focus on problems the agency has encountered in five major areas: (1) implementing the Federal Credit Reform Act of 1990 and related accounting standards,1 (2) reconciling its Fund Balance with Treasury accounts, (3) addressing weaknesses in the Forest Service’s financial accounting and reporting, (4) correcting certain other material internal control weaknesses, and (5) complying with some key laws and regulations. I will also briefly discuss our assessments of the Rural Utilities Service’s (RUS) electric loan program policies and procedures and the risk of loss to the federal government from direct loans or loan guarantees RUS provides to electric cooperatives.

USDA is responsible for a variety of major programs that (1) boost farm production and exports, (2) promote small community and rural development, (3) ensure a safe food supply for the nation, (4) manage natural resources, and (5) improve the nutrition of families and individuals with low incomes. The financial results of the activities of these programs are reported in USDA’s consolidated financial statements and make up a significant portion of certain components of the consolidated financial statements of the U.S. government. For example, USDA is responsible for managing the nation’s largest federal direct loan portfolio, with reported net credit program receivables of about $70.7 billion as of September 30, 1999. In addition, USDA reported net costs of $32.7 billion for fiscal year 1999 for its food assistance programs such as the Food Stamp Program (FSP) and Child Nutrition Programs (CNP), that represent a significant portion of income security net cost reported in the U. S. consolidated financial statements.

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1The Federal Accounting Standards Advisory Board (FASAB) developed the accounting standard for credit programs, Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct Loans and Loan Guarantees (SFFAS No. 2), which became effective beginning in fiscal year 1994.
Background

Improving financial accountability throughout the federal government has been an area of emphasis since implementation of the Chief Financial Officers (CFO) Act of 1990, which required a CFO structure in 24 major agencies and the Office of Management and Budget (OMB) to provide the necessary financial management leadership and focus. To help instill greater accountability and fix pervasive and costly control breakdowns, financial statements were required to be prepared and audited, beginning with those for fiscal year 1991, for revolving and trust funds and commercial activities. For 10 agencies— including USDA—audited financial statements were required as part of a pilot program to test this concept for an agency's entire operations.

Since USDA's participation in the pilot program in 1991, USDA and several of its component agencies have received a series of unfavorable financial audit reports due to deficiencies in financial reporting that are attributable primarily to weaknesses in the agency's financial management systems. USDA's Chief Financial Officer recognizes the seriousness of these problems and has a number of efforts underway to address these issues.

The Government Management Reform Act (GMRA) of 1994 expanded the CFO Act by mandating that (1) major departments and agencies produce annual financial statements subject to independent audit, beginning with those for fiscal year 1996, and (2) the Secretary of the Treasury, in cooperation with the Director of the Office of Management and Budget, prepare financial statements for the U.S. government that are audited by GAO, starting with those for fiscal year 1997.

In addition, the Congress passed the Federal Financial Management Improvement Act (FFMIA) of 1996, Public Law 104-208. FFMIA requires auditors for each of the 24 major departments and agencies named in the CFO Act to report, as part of their audit report on agencies' annual financial statements, whether the agencies' financial management systems comply substantially with three requirements: (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the U.S. Government Standard General Ledger (SGL). In the transaction level. These requirements are critical for ensuring that agency financial management activities are consistently and accurately recorded and promptly and uniformly reported throughout the federal government. Departments and agencies must comply with these

\[2\text{The SGL provides a standard chart of accounts and standardized transactions that agencies are to use in all their financial systems.}\]
requirements in order to maximize their performance and ensure their accountability.

As USDA’s financial statements have continued to be subjected to annual audits, the agency’s history of deficiencies in financial reporting has continued. Many of these weaknesses persist because of (1) an outdated accounting system and (2) problems with supporting computerized systems—referred to by USDA as feeder systems. The USDA IG has reported that the old accounting system does not comply with the requirements of FFMIA because, among other things, it does not conform with the SGL. In addition, the IG reported that the feeder systems—which include information such as billing, purchases, and real and personal property activities—are poorly documented, operationally complex, deficient in appropriate control processes, and costly to maintain.

In order to help address these systems problems, on December 23, 1994, the Office of the Chief Financial Officer (OCFO) purchased a new accounting system, the Foundation Financial Information System (FFIS), with the goal of replacing the old accounting system USDA-wide. But while USDA has implemented the new system in several component agencies, it has experienced delays in agencywide implementation. The agency plans to complete implementation of the system USDA-wide by October 1, 2002. Meanwhile, USDA’s CFO has agreed with the IG’s recommendation to develop a long-range plan to consolidate, integrate, and/or reengineer the feeder systems.

USDA’s fiscal year 1999 audit was conducted by the Office of Inspector General. We reviewed the IG’s workpapers between January and February 2000. We shared a draft of this statement with USDA officials, who provided us some clarifying comments. We have incorporated their comments where appropriate. Our work was conducted in accordance with generally accepted government auditing standards.

Prior to the implementation of the Federal Credit Reform Act (FCRA) of 1990, credit programs—like most other federal programs—were reported in the budget on a cash basis. Thus, loan guarantees appeared to be free in the budget year, while direct loans appeared to be as expensive as grants. As a result, costs were distorted and credit programs could not be compared meaningfully with other programs and with each other. FCRA and the related accounting standard, together known as credit reform, were enacted to more accurately measure the government’s costs of federal loan programs and to permit better comparisons both among credit programs and between credit and noncredit programs. As part of
implementing credit reform, agencies are required to estimate the net cost of extending credit, generally referred to as subsidy costs, based on the present value\(^3\) of estimated net cash flows, excluding administrative costs.

Since 1994,\(^4\) the IG has reported material weaknesses in the processes and procedures used by USDA’s lending agencies to estimate and reestimate loan subsidy costs. In January 1999, we reported\(^5\) that the agency was unable to make reasonable estimates of the cost of its loan programs because it did not maintain key historical data needed as a basis to estimate future cash flows and that USDA’s computer systems were not configured to capture the data needed to make the estimates. The USDA CFO established a task force in March 1999 to assist in resolving the agency’s credit reform problems. To date, USDA has not provided the resources needed to properly address this problem. As a result, progress has been slow.

Since USDA is the largest direct lender in the federal government and the amount involved is material, the agency’s inability to properly implement credit reform will continue to contribute to our inability to give an opinion on the consolidated financial statements of the U.S. government. Additionally, for most of USDA’s credit programs, cost estimates based on unreliable data can affect the availability of credit programs to potential borrowers because changes in these estimates can affect the number and amount of loans and guarantees which can be made.

**USDA Lacks Adequate Systems and Historical Data to Reasonably Estimate the Cost of Its Credit Programs**

Because loan program cost estimates are based on estimated cash flows, agencies have to be able to predict borrower behavior—how many borrowers will pay early, pay late, or default on their loans, and at what point in time. Generally, the best predictor of borrower behavior is prior historical data adjusted for expected changes in future economic events. Agencies use this historical information and sophisticated computer models, known as cash flow models, to estimate the cost of a loan program. USDA has not been able to make reasonable financial statement cost estimates for its loan programs because it does not maintain some of

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\(^3\)Present value is the worth of a future stream of returns or costs in terms of money paid immediately. In calculating present value, prevailing interest rates provide the basis for converting future amounts into their "money now" equivalents.

\(^4\)1994 was the first year in which agencies were to apply credit reform in their financial reporting, following FASAB’s publication of SFFAS No. 2 in July 1993.

\(^5\)Credit Reform: Key Credit Agencies Had Difficulty Making Reasonable Loan Program Cost Estimates (GAO/AIMD-99-31, January 29, 1999).
the key historical data needed to predict borrower behavior. This problem also raises questions about the quality of the budget data related to USDA's loan programs since the accounting data underlying credit reform is generally derived from the same sources as the related budget data.

Because USDA lacks historical information, it bases some of its predictions of borrower behavior, such as the amount and timing of future defaults and prepayments, primarily on the opinion of program managers. While program management opinion may be used when a new or unique program is established, it should only be an interim method and does not provide the reliable basis for estimating borrower behavior that historical data adjusted for changes in future economic events does. Further, program manager opinion, when used, should be compared to actual cash flow data to corroborate the reasonableness of management's judgement. However, USDA does not routinely perform these comparisons.

The lack of historical data is largely the result of system inadequacies. Prior to the implementation of credit reform, USDA systems did not track certain key cash flow data that are critical to estimating the cost of a loan program. For example, because USDA's systems were incapable of accumulating summary level information on when borrowers had paid their loans early, the agency's ability to calculate reasonable estimates of future borrower early payments was limited. In addition, some of the key cash flow data in the system are suspect. For example, USDA's system for reporting some of its non-housing direct loans contains inaccurate data on the number of payments borrowers make each year. As a result, the agency cannot reasonably estimate the amount of cash that should be received annually from borrowers using these data.

**USDA Has Not Allocated the Resources Needed to Correct Credit Reform Issues**

USDA has made limited progress in addressing the deficiencies related to reasonably estimating the cost of its loan programs. The primary reason for the limited progress has been a shortage of resources, both staff and funds, to properly address the problem. USDA developed an action plan to address deficiencies in estimating the cost of its loan programs and established a task force that comprises representatives from budget, program, accounting, and IG offices to assist in resolving the agency's credit reform problem. We have provided extensive guidance and consultation to this task force, and in December 1999, we briefed the USDA Executive Steering Committee for Credit Reform Implementation.

6The Steering Committee includes the Chief Financial Officer, Rural Development Deputy Under Secretary for Operations and Management, Farm Service Agency Administrator, and Assistant Inspector General for Audit.
on the progress that the task force had made during the year, highlighting the large amount of work that remained to be done.

USDA recognizes the need to hire additional qualified staff to help make reasonable estimates of its loan program costs. During 1999, two budget staff and one budget assistant were internally reassigned to work in this area. In addition, in May 1999, the agency started the lengthy process to hire additional staff. To date, one additional person has been hired. However, none of these people work full time on addressing the problems. Instead, these staff, as well as other staff in the finance office, attempt to resolve the complex problems associated with credit reform while performing other duties.

In April and June 1999, we met with the Steering Committee and discussed how other agencies had successfully used outside contractors to help estimate the cost of their credit programs. Specifically, these agencies had used contractors to help gather adequate historical data, establish a reliable basis for cash flow estimates, and improve the agencies’ cash flow models. USDA obtained limited funding late in fiscal year 1999 to contract with an independent public accounting firm to assess loan accounting systems data availability related to its direct loan housing programs.

This is just one of several steps that remain to be completed before the agency will be able to make reasonable estimates of loan program costs. Other significant tasks that have yet to be completed include developing and implementing new cash flow models for USDA’s direct loan housing program and its guaranteed loan programs, comparing estimated loan performance to historical cash flow data to determine whether the estimates reasonably predicted borrower behavior, testing key cash flow data maintained in the systems to determine whether they accurately reflect loan file contents, and completing efforts to document policies and procedures for estimating the cost of its loan programs.

Despite the lack of adequate historical data and adequate resources dedicated exclusively to resolving these long-standing deficiencies, some progress has been made. For example, sensitivity analysis has been done for some agency programs to identify the key cash flow assumptions that have the greatest impact on the loan program cost estimates. These assumptions include the average interest rate borrowers pay and the number of payments borrowers make each year. Further, USDA loan program regulatory and legislative requirements have been summarized and compared to some of the cash flow models to ensure that the models address all aspects of the agency’s credit programs. In addition, some of the cash flow models have been reviewed, and formula and logic errors
have been identified and corrected. Preliminary efforts are also underway to assess the quality of the data that are used to predict loan program performance. However, without a significant increase in resources dedicated to resolving this problem, measurable progress will continue to be slow.

USDA Credit Reform Issues Impact Budget Estimates and Consolidated Financial Statements Opinion

USDA is the largest direct federal lender, with reported credit program receivables of about $70.7 billion as of September 30, 1999. As these loans are significant to the federal government's financial statements, USDA's inability to make reasonable cost estimates for its loan programs will continue to contribute to our inability to give an opinion on the consolidated financial statements of the U.S. government. This problem also raises questions about the quality of the budget data related to USDA's loan programs since the accounting data under credit reform generally mirror the related budget data. This "mirroring" provides the opportunity to improve the integrity of the budget estimates through the financial statement audit. However, USDA has not yet seized this opportunity.

Providing reasonable credit program cost estimates based on reliable data is critical to effective program stewardship and accountability. For most of USDA's credit programs, unreliable information can affect the availability of credit programs to potential borrowers because changes in cost estimates can affect the number and amount of loans and guarantees available. For example, if the agency initially underestimates the cost of a loan program, it will spend more than expected over time to provide the amount of loans it told the Congress could be made for the initial cost. On the other hand, if USDA initially overestimates a loan program's cost, less credit would likely be made available to borrowers than if the cost of the program had been better estimated. Therefore, until USDA is able to provide reasonable estimates, the Congress does not have valid cost data on which to base its decisions about whether to expand or scale back the agency's loan programs.

USDA Is Unable to Reconcile Fund Balance With Treasury Accounts

USDA records its budget authority in asset accounts called Fund Balance with Treasury and increases or decreases these accounts as it collects or disburses funds. The Inspector General was unable to fully substantiate the Fund Balance accounts with the U.S. Treasury, which totaled over $38 billion as of September 30, 1999, because the agency had not reconciled the balance with the amount reported by Treasury. Prior to May 1999, USDA merely adjusted its records to agree with Treasury's without determining which, if either, number was correct, and did not
establish or analyze the causes of the differences between its and Treasury’s records before reporting its ending balance to Treasury. Since May 1999, USDA discontinued adjusting its records to agree with Treasury’s records and began disclosing any differences in its reports to Treasury. Because most assets, liabilities, revenues, and expenses stem from or result in cash transactions, errors in the receipt or disbursement data affect the accuracy of various USDA financial reports, including certain data concerning fiscal year 1999 obligations and outlays that USDA provided for inclusion in the President’s Budget.

The Office of the Inspector General first identified unreconciled differences between USDA and Treasury records in its fiscal year 1992 audit. According to the IG, differences in some instances have gone uncorrected for more than 10 years. In May 1999, USDA established a goal of reconciling differences within 120 days after Treasury notified USDA of discrepancies between USDA and Treasury records. However, USDA has not been able to meet this goal to date. As of September 30, 1999, the IG reported the unreconciled amount was about $5 billion. Unreconciled amounts continue to occur because of, among other things, timing differences, missing documentation, input errors, and the inability of USDA feeder systems to properly transfer data to the accounting system and/or the accounting system’s inability to record transactions in the correct general ledger accounts.

USDA formed a task force consisting primarily of members representing the Forest Service, the National Finance Center (NFC), USDA’s Office of the Chief Financial Officer, and an outside consultant—PricewaterhouseCoopers LLP—to resolve outstanding differences and develop procedures that will prevent this problem from recurring in the future. In addition, we and the IG have monitored this effort for the past 6 months. The task force anticipates that the reconciliations and implementation of procedures to prevent this problem from recurring will be completed by March 31, 2000, a date we consider to be optimistic. Until this problem is corrected, the integrity of much of USDA’s financial data is questionable.

The Forest Service is a major USDA component agency. It accounts for a substantial portion of USDA’s general property, plant, and equipment and almost all of USDA’s stewardship land. As of September 30, 1999, the Forest Service reported $3.1 billion of general property, plant, and equipment—82 percent of USDA’s total—and 192 million acres of national forest land and grasslands that the Forest Service holds in stewardship for current and future generations.
Since the first audit of the Forest Service’s financial statements, which covered fiscal year 1991, USDA’s IG has found serious accounting and financial reporting weaknesses, some of which continue to exist today. For example, while the Forest Service implemented its new accounting system agencywide on October 1, 1999, as scheduled, the system is supported by feeder systems that the IG has described as, among other things, deficient in appropriate control processes and costly to maintain. Furthermore, the independence afforded by the agency’s autonomous field structure has hampered efforts to correct accounting and financial reporting weaknesses. These shortcomings mean that the agency and the Congress do not have accurate financial data to track the cost of programs and activities and to help make informed decisions about future funding. They also raise questions about the accuracy of program performance measures and of certain budget data drawn from the same database.

The Forest Service has completed several actions and begun others that, if successfully carried through, represent important steps toward achieving financial accountability. Nevertheless, as we testified before your Subcommittee in July 1998, major barriers remain, and the Forest Service may need several years to achieve financial accountability. Therefore, in January 1999, we designated the Forest Service’s financial management as a high-risk area because of the serious and long-standing accounting and financial reporting weaknesses plaguing its operations. Because of this high-risk designation, we will give sustained attention to monitoring the Forest Service’s efforts to achieve financial accountability.

New Accounting System Implemented

The Forest Service implemented USDA’s new accounting system on October 1, 1999, as scheduled. Previously, the IG, an outside consultant, and we have reported problems the agency encountered attempting to implement the system at the Forest Service. For example, in October 1998 we reported that (1) the agency had not fully tested the system before attempting to implement it, (2) the agency had encountered problems with the system transferring data to other systems, and (3) the overall implementation project lacked adequate oversight and management control. USDA developed a strategic plan to address reported problems, and established a project management office that had only one objective—developing and carrying out the strategic plan for implementing the new system departmentwide.

Despite some start-up problems, such as rejected transactions and system downtime, Forest Service staff are now entering fiscal year 2000 transactions into the system. However, the new accounting system depends on and receives data from feeder systems that the IG and the Logistics Management Institute—a consultant for USDA—have characterized as seriously deficient. Specifically, the IG reported that these feeder systems—which process and transfer information such as credit card, personal property, and travel transactions into the new accounting system—are poorly documented, operationally complex, deficient in appropriate control processes, and costly to maintain. The IG has also concluded that these feeder systems reduce assurance that the new system will be able to provide timely, accurate, reliable, and consistent financial information. USDA has agreed with the IG’s recommendation to develop a long-range plan to consolidate, integrate, and/or reengineer the feeder systems.

**Accounting and Reporting Deficiencies Remain**

The Inspector General’s February 2000 audit report on the Forest Service’s fiscal year 1999 financial statements—a disclaimer of opinion—shows that the agency remains unable to reliably track and report on major assets worth billions of dollars. For example, the IG found several reporting errors in the Forest Service’s supporting accounting records for its $1.1 billion of individual real property assets, such as buildings, recreation sites, dams, and utility systems. In addition, the IG reported that the Forest Service’s portion of the USDA Fund Balance with Treasury account could not be verified because the reconciliation of this account had not been completed. This account, which is similar in nature to a checking account with the U. S. Treasury, contained $2.6 billion as of September 30, 1999.8

In addition, the Forest Service has over $100 million in unsupported balances remaining from its old accounting system. These unsupported balances resulted largely from the Forest Service’s use for some 20 years of an accounting system that did not meet basic federal requirements. The Forest Service faces a major effort in trying to (1) document and validate these balances so they can be converted to the new system or (2) reach agreement with the IG on a policy for resolving the remaining amounts.

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8As previously stated, a USDA-wide task force was established to correct the weaknesses associated with the Fund Balance with Treasury account.
Current Field Structure Hampers Accountability

In our February 1998 report,\(^9\) we stated that the Forest Service's autonomous organization may hinder top management's ability to gain the full participation of all regional fiscal directors in efforts to achieve financial accountability. An independent contractor's report issued in March 1998, which addressed financial management and organizational analysis at the Forest Service, also raised the issue of the agency's autonomous structure.\(^10\) Further, the contractor reported that whether the subject is budget execution, financial plan development, or accounting for reimbursable agreements, each unit operates independently.

The Forest Service restructured its national office management team in April 1998 to create functional lines of accountability for fiscal management by establishing a Chief Financial Officer position that reports directly to the Chief Operating Officer of the Forest Service. A Forest Service official told us in January 2000 that a decision about hiring chief financial officers at the regional level will be made following completion of a study of the Forest Service's financial management field structure during fiscal year 2000. The establishment of the Chief Financial Officer in the national office addresses some of the concerns we have previously raised regarding management structure. However, the key issue regarding the Forest Service's decentralized and autonomous field structure as it relates to financial management remains unresolved.

High-Risk Designation

Since 1990, we have periodically reported on government operations that we have identified as high risk because of their greater vulnerabilities to waste, fraud, abuse, and mismanagement. Our high-risk status report is now provided at the start of each new Congress. We designated Forest Service's accounting and financial reporting in our latest, *High-Risk Series: An Update* (January 1999, GAO/HR-99-1), because of the agency's severe weaknesses in this area.

In order to be removed from the list, the Forest Service will need to demonstrate sustained financial accountability, which goes beyond receiving an unqualified audit opinion. The Forest Service will also need to address material internal control weaknesses that limit its ability to maintain accountability over its assets on an ongoing basis. For example, it needs to implement a system of controls to properly record, track, and

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Corrective Measures Are Underway

In October 1999, we reported\(^{11}\) that the Forest Service had completed several corrective actions and begun others that, if successfully carried through, represent important steps toward achieving financial accountability. To its credit, the Forest Service has achieved some major accomplishments so far this fiscal year in addition to implementing the new accounting system. Specifically, the Forest Service has accomplished the following:

- made significant progress in completing its physical inventory of real and personal property, as well as developing a methodology for valuing its road assets;
- begun implementation of a new methodology for tracking and reporting the cost of its operations;
- continued staffing its newly organized Office of Finance;
- received a final report, Financial Statement Risk Assessment, from its consultant that assessed the relative audit risk of financial statement line items, thereby enabling the Forest Service to prioritize its efforts and develop a realistic time-line to achieve a clean opinion;
- developed a plan to study the Forest Service's highly decentralized and autonomous field office financial management structure; and
- finalized a long-range plan with goals and objectives, timeframes, and measures for attaining financial accountability.

As these accomplishments demonstrate, the Forest Service has made progress in addressing its financial management deficiencies and is on the right track towards financial accountability. However, much work remains, and sustained top management commitment is necessary to ensure that progress continues.

\(^{11}\)Forest Service: A Framework for Improving Accountability (GAO/AIMD-00-2, October 1999).
Material Internal Control Weaknesses Hamper Accountability

A strong internal control system provides the framework for the accomplishment of management objectives, accurate financial reporting, and compliance with laws and regulations. Effective internal controls serve as checks and balances against undesired actions and, as such, provide reasonable assurance that agencies operate in a safe and sound manner. The lack of good internal controls puts an agency at risk of mismanagement, waste, fraud, and abuse. Further, without strong internal controls, an agency is unable to generate consistent, reliable financial information needed to maintain accountability over its assets on an ongoing basis.

At USDA, several persistent internal control weaknesses contributed to the IG's inability to form an opinion on the agency's fiscal year 1999 consolidated financial statements. These weaknesses, as well as others identified by the IG, are discussed below.

Food Stamp Recipient Claims

The IG has reported material internal control weaknesses related to Food and Nutrition Service (FNS) food stamp recipient claims since fiscal year 1991. FNS relies on state agencies to administer the program and collect and report on any overissuance of Food Stamp benefits. FNS has been working with state agencies to put systems and procedures in place to collect overissued Food Stamp benefits, which were estimated to total $193 million\(^{12}\) as of September 30, 1999. However, as of July 1999, FNS noted that only 21 of the 53 state agencies have claim systems that can report accurate, complete, and supportable information on overissued Food Stamp benefits and related collections. Thirty state agencies have prepared corrective action plans to address reported deficiencies in their systems and the remaining two have not prepared corrective actions plans. FNS must continue to work with state agencies on implementing systems and controls to properly identify and collect overissuances because program funds are lost when claims are not established promptly and pursued vigorously.

Financial Management Systems

Since fiscal year 1997, the IG has reported that USDA's financial systems do not always process and report departmentwide financial information accurately. The IG has reported that many of these systems are not fully integrated with other USDA systems and do not fully comply with federal regulations.

\(^{12}\)This amount represents USDA's estimate of collectible overissued amounts. However, USDA statistically projected that total overissuance of food stamps could have been as much as $1.3 billion for fiscal year 1998.
financial management systems requirements. Among the more serious problems cited by the Inspector General were that USDA

- had a net difference of about $130 million between its accounting records and the supporting personal property system;

- had a payroll system that contained data dating as far back as 1979 that had not been properly analyzed; and

- lacked controls to ensure that transactions recorded in its old accounting system were accurate and properly authorized.

It is critical that USDA correct these problems by implementing new or revamped systems that are properly designed and implemented to integrate budgetary and cost information with external reporting to provide USDA with the capability to accurately track assets and identify all costs associated with an activity.

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<td>The IG reported that material internal control problems exist in the accountability and valuation of personal property at agency field offices, headquarters, and the National Finance Center. For example, the IG noted that about 60 percent of approximately 10,000 USDA accountable property officers as of December 7, 1999, were either delinquent in performing physical inventories or had never recorded that an inventory had been taken. In addition, IG staff noted that documentation supporting the purchase price of property was lacking, and numerous errors in the property values were recorded in the system. For example, the staff found a motor vehicle recorded in the system at over $97 million and a microscope recorded in the system at $11 million. Until all counts are taken and recorded in the accounting records, USDA does not fully know what assets it has, where they are, and what they are worth. Further, the Congress cannot be assured that USDA requests for additional funds to purchase property and equipment are fully warranted.</td>
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<th>Information Technology Security and Controls</th>
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<td>The IG reported that tests of USDA’s computer network disclosed significant security vulnerabilities that require immediate action. The IG stated that USDA is vulnerable to abuse and losses because few of its</td>
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13We have also reported on USDA’s information security weaknesses at the National Finance Center (USDA Information Security: Weaknesses at National Finance Center Increase Risk of Fraud, Misuse, and Improper Disclosure (GAO/AIMD-99-227, July 30, 1999)).
component agencies comply with the departmental regulation that requires that sensitive and Privacy Act data not be transmitted in clear text over the Internet. In addition, USDA did not have a proactive network monitoring and intrusion detection program. Such a program would require component agencies to promptly identify and investigate unusual or suspicious network activity, such as repeated failed attempts to log onto the network; attempts to identify systems and services on the network; connections to the network from unauthorized locations; and efforts to disrupt operations by overloading the network. Without these controls, USDA has little assurance that unauthorized access to systems on its network would be detected in time to prevent or minimize damage.

**USDA Does Not Fully Comply With All Key Laws and Regulations**

Generally accepted government auditing standards require auditors to report on whether or not agencies complied with laws and regulations where instances of noncompliance could have a material impact on the agency’s financial reporting. Instances of noncompliance include situations in which an agency fails to follow a requirement of a law or regulation or performs an act that is prohibited by a law or regulation. The management of USDA is responsible for complying with laws and regulations that are applicable to the agency. The IG reported some instances in which USDA was noncompliant, including the following:

- The IG noted that some component agencies’ financial management systems do not substantially comply with the three requirements of FFMIA. The act requires agencies to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the *Standard General Ledger* at the transaction level. USDA has prepared a remediation plan that includes corrective actions that are scheduled to be completed no later than September 2003.

- The IG noted that USDA’s lending agencies are not in full compliance with some of the provisions of the Debt Collection Improvement Act. The purpose of the act is to maximize collections of federal non-tax debt by directing actions towards debtors with the ability to pay and to minimize the costs of debt collection by consolidating related functions and activities. The IG found that the National Finance Center did not refer debt that was delinquent over 180 days to Treasury for cross-servicing. The Center did not forward the debt because it was waiting for notification from Treasury as to whether it would be designated as a debt collection center. In January 2000, the Center was notified that it would not be designated a debt collection center. Therefore, it plans to begin referring delinquent debt to Treasury later this year.
The IG also concluded that USDA has not fully addressed two problems related to compliance with the CFO Act. Specifically, the agency has not implemented a fully integrated financial information system. The current system relies on data from various program and administrative systems throughout the agency in order to prepare USDA's consolidated financial statements. In addition, USDA has not (1) conducted required biennial reviews of the fees, royalties, and other charges imposed by USDA agencies for services and (2) made recommendations on revising those charges to reflect costs incurred by the agencies in providing those services as required by the CFO Act. The IG noted that one agency did not update its user fees for its inspection services for fiscal year 1998 and part of fiscal year 1999. As a result, the agency did not bill for millions of dollars that it was entitled to receive because the fees were not adjusted for salary increases and inflation factors.

Rural Utilities Service Electric Loan Portfolio Issues

RUS provides direct loans or loan guarantees primarily to rural electric cooperatives that market power on a wholesale and retail basis. As of September 30, 1999, RUS' entire portfolio of loans—including direct and guaranteed electricity, telecommunications, and water and waste disposal loans—totaled about $35 billion of the $70.7 billion of USDA's net credit program receivables. Of the $35 billion in RUS loans, $25 billion (or 71 percent) consisted of electric loans.

Most RUS borrowers are either generation and transmission (G&T) cooperatives or distribution cooperatives. A G&T cooperative is a nonprofit rural electric system whose chief function is to produce and sell electric power on a wholesale basis to its owners, who consist of distribution cooperatives and other G&T cooperatives. A distribution cooperative sells the electricity it buys from a G&T cooperative to its owners, the retail consumers.

Most RUS direct loans and loan guarantees were made during the late 1970s and early 1980s. For example, from fiscal years 1979 through 1983, RUS approved direct loans and loan guarantees of about $29 billion, whereas during fiscal years 1992 through 1999, it approved a total of about $5 billion in direct loans and loan guarantees. During the late 1970s and early 1980s, RUS provided financing for several G&Ts that had invested in the construction of large nuclear-generating and coal-fired generating power plants. Several of these plants were completed late and over budget. In addition, an expected increase in demand for electric power did not materialize. As a result, several of these G&Ts became financially troubled and could not meet their debt-servicing requirements. In turn, the federal government incurred several billion dollars in loan losses.
As we previously testified before this Subcommittee, RUS has had, and continues to have, significant financial problems with the electric loan portfolio. For example, from fiscal year 1992 through July 31, 1997, RUS wrote off about $1.5 billion of loans to four rural electric cooperatives. The most significant write-offs relate to two G&T loans. In fiscal year 1996, one G&T made a lump sum payment of $237 million in exchange for RUS writing off and forgiving the remaining $982 million of its RUS loan balance. In fiscal year 1997, another G&T borrower made a lump sum payment of approximately $238.5 million in exchange for write-off and forgiveness of its remaining $502 million loan balance. Since 1997, the agency has written off an additional $330 million of loans to two rural electric cooperatives and is in the process of writing off an additional $3 billion of the total $4.1 billion in loans owed by Cajun Electric, a RUS borrower that has been in bankruptcy since December 1994. Cajun Electric filed for bankruptcy protection after the Louisiana Public Service Commission disapproved a requested rate increase and instead lowered rates to a level that reduced the amount of revenues available to Cajun to make annual debt service payments. In addition to these past and anticipated write-offs, we have reported that it is probable that the agency will continue to incur losses in the future.

In our February 2000 report on RUS’ loan origination policies and procedures for making G&T loans to electric cooperatives, we noted that RUS’ loan origination policies are reasonably designed to mitigate future loan losses to the government and are generally consistent with banking industry standards. However, RUS lacks implementing procedures in certain key areas to carry out its policies for determining whether to make G&T loans. Specifically, RUS does not have implementing procedures to (1) assess some of the primary documents which must be prepared by the borrower to support the loan application and (2) document its loan assessment and recommendation that a loan be approved. Because RUS lacks implementing procedures to carry out its G&T loan origination policies in certain key areas, misinterpretation and/or inconsistent implementation of the loan origination policies could occur. In order to ensure consistent implementation of G&T loan origination policies, we recommended that the Secretary of Agriculture direct the Acting

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17See footnote 16.
Administrator of RUS to develop and document written procedures for the two areas mentioned above. Agency officials have agreed with our recommendation.

In conclusion, USDA is a large, complex agency with many difficult issues to address before it can be accountable to you, the Congress, and taxpayers for the money provided to carry out its varied missions. Many of the problems are deep rooted and will take time, sustained top management commitment, and substantial resources to correct. Therefore, continued congressional oversight, such as this hearing, are essential to help ensure that USDA focuses adequate attention on resolving its financial management deficiencies.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other Members of the Subcommittee may have.

Contact and Acknowledgements

For information about this statement, please contact Linda M. Calbom at (202) 512-9508. Individuals making key contributions to this statement included Dan Blair, Carla Lewis, Kelley Quinn, McCoy Williams, and Maria Zacharias.
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